Regulators and the Quest for Coherence in Finance:

Received: 15 February 2018 | Revised: 29 August 2018 | Accepted: 1 September 2018

DOI: 10.1111/padm.12549

public administration WILEY

SYMPOSIUM ARTICLE

Regulators and the quest for coherence in finance: The case of loss absorbing capacity for banks

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Funding information
Hanse Wissenschaft Kolleg, Grant/Award Number: residential fellowship; Scuola Normale Superiore, Grant/Award Number: Residential fellowship

After the international financial crisis, new financial regulation was adopted at the international, regional and national levels, raising the issue of how to promote regulatory coherence, defined as the consistency between the rules adopted at different governance levels and in a variety of policy venues. A major recent area of reform concerned the loss absorbing capacity (LAC) of banks. In practice, the lack of regulatory coherence concerning LAC hampers the effective resolution of large international banks in a timely manner, ultimately undermining financial stability. We examine the role of regulators in the quest for coherence on LAC, explaining the incentives they had and how they deployed their delegated competences at different levels to achieve coherent rules that ensure financial stability. Theoretically, we combine insights from the public administration and political economy literatures. Methodologically, we process trace the making of LAC rules on three governance levels and in multiple policy venues.

1 | INTRODUCTION

After the international financial crisis, a host of new financial regulations were adopted (Moschella and Tsingou 2013). One of the main and most recent areas of regulatory reform concerned the loss absorbing capacity (LAC) of banks, that is to say, the ability of banks to withstand financial stress by imposing losses on creditors (bail-in), without resorting to state-funded recapitalization (bail-out). This post-crisis reform followed the recognition that relying predominantly on more stringent capital requirements for banks (the core instruments of pre-crisis prudential regulation) was insufficient and additional loss absorbing instruments were needed, especially for global systemically important banks (G-SIBs).[1] New rules on LAC were adopted at the international, regional (European Union) and national levels, raising the issue of how to secure regulatory coherence, defined as the consistency between the rules adopted at different governance levels and in a variety of policy venues.

[1]A bank is deemed to be a global systemically important one if its collapse would severely impair the proper functioning of the global financial system. The Financial Stability Board (FSB) has designated around 30 global banks as G-SIBs using methodology designed by the Basel Committee on Banking Supervision (BCBS).

Regulatory coherence is important theoretically and in practice. Theoretically, we know relatively little about what promotes (or hampers) the consistency of rules across multiple interconnected policy venues and governance levels. In practice, the lack of regulatory coherence concerning LAC makes G-SIBs very difficult to resolve effectively in a timely manner because different sets of rules would apply to different parts of the bank and its balance sheet. Ultimately, this undermines financial stability and the global efforts to create a more robust crisis management regime.

The difficulty of securing post-crisis regulatory coherence regarding LAC is puzzling. Indeed, one would have expected LAC to be a 'most-likely case' for regulatory coherence to occur for two main reasons. First, international discussions of LAC rules started only after substantial sets of rules on capital, liquidity and resolution had already been agreed upon at the international level and, subsequently, extensively harmonized at the European Union (EU) and national levels. We would expect that the legacy of harmonization would facilitate the adoption of subsequent, and related, rules. Second, in comparison to large regulatory packages, such as the Basel III Accord on capital and liquidity for banks, LAC rules are technical and narrow in scope. Thus, coherence should have been relatively easy to achieve. However, as we show in this article, regulatory coherence was problematic.

We assess and explain the coherence between international, EU and national rules on LAC, which is an under-investigated but crucial area of post-crisis reform in finance. We consider LAC as an instance of multi-level, multi-venue rule-making, which is increasingly widespread in the governance of finance. We ask: to what extent and why was coherence on LAC rules promoted? We focus specifically on the role of regulators who, for the purpose of our analysis, are central bankers, bank supervisors and resolution authorities involved in rule-making and enforcement. Unlike other domestic actors (notably, elected officials), regulators are active at various governance levels and in a multiplicity of policy venues, often with different competences.

We aim to refine and advance the understanding of multi-level multi-venue regulatory coordination processes by combining theoretical insights from the public administration and political economy literatures. The public administration literature has highlighted the importance of independent regulatory agencies at the national and the EU levels (Coen and Thatcher 2008; Bach et al. 2016; Heims 2016). For example, Egeberg and Trondal (2016) have shown how agencies can create 'organizational compromises' that foster the development of consistent rules across different policy venues and governance levels. Furthermore, at the international level, networks of regulators are increasingly active in regulatory harmonization and policy coordination between national officials (see the special issue of *Public Administration* 2015, 93(4); Eberlein and Newman 2008; Jordana 2017). The political economy literature has shown that there are important 'transnational feedbacks' between international and domestic regulatory changes (Newman and Posner 2016, 2018) and that 'transgovernmental coordination' can facilitate the resolution of rule overlaps and disputes (Farrell and Newman 2014). Therefore, we would expect regulators to play an important role in seeking to ensure coherent rule-making in multi-level multi-venue regulatory processes. We draw on the political economy literature to unpack the incentives of regulators in reconciling diverse policy goals (e.g., Kapstein 1992; Singer 2007), such as ensuring domestic and global financial stability and preserving the competitiveness of domestic banking systems. We also consider how the delegated competences of regulators as rule-makers, rule-drafters and advisers affect their ability to promote coherence.

This article speaks to one of the main themes of the symposium, namely, the delegation of regulatory competences to central banks, particularly in their capacity as banking supervisors and (less frequently) resolution authorities. We argue that regulators were the main actors promoting coherence when they were involved in shaping LAC rules at the international, EU and national levels. Moreover, related to the bureaucratic politics theme of the symposium, we argue that regulators' capacity to craft coherent rules was greater at the international level, where they negotiated directly with their counterparts, whereas in the EU and, especially, at the national level elected officials prioritized national concerns, which in some cases undermined coherence.

We argue that financial regulators were key players in the quest for coherence on LAC because of their incentives related to financial stability, especially to ensure the resolvability of cross-border banks in practice. Similarly to Ban and Patenaude's analysis (this issue), we detect a greater necessity to forge an international consensus on important post-crisis financial regulation. However, due to the heightened domestic scrutiny of international rule-making, other domestic actors with different priorities also managed to shape the adopted rules, especially at the national level, which made the quest for regulatory coherence rather elusive.

The article is organized as follows. First, we present the analytical framework, followed by an overview of the maze concerning post-crisis LAC regulation and its political economy. We then investigate rule-making on LAC at the international, regional (EU) and national levels, respectively. At each level, we outline the main policy venues, the key actors, the dynamics of the rule-making process, and the extent of coherence in the regulatory output (the adopted rules). The penultimate section considers two alternative explanations and the last section sums up the main findings.

2 | ANALYTICAL FRAMEWORK: WHY AND HOW DO FINANCIAL REGULATORS SEEK TO PROMOTE COHERENT RULES?

We define regulatory coherence as the degree of consistency between the rules adopted (regulatory outputs) at different governance levels and in a variety of policy venues. Regulatory coherence in a given policy field, or on a given issue, can be assessed vertically, that is to say between levels of governance, as well as horizontally, that is to say across policy venues at a given level. Our definition of coherent outputs is similar to Egeberg and Trondal's (2016, p. 579) conceptualization of achieving 'more consistency among decisions horizontally as well as vertically' in contemporary policy systems. Jurisdictions (or different governance levels) may specify different rules that still do not contradict each other and can be applied consistently. In that case, we consider the different rules to be coherent. We detect a lack of coherence or fragmentation when the output at one level of governance contradicts, or even undermines, rules agreed upon at different levels.

While our investigation is embedded in the broader literature on processes of regulatory coordination, using the term 'coherence' is particularly suitable for our multi-level multi-venue analysis and focus on the consistency between the rules adopted at different levels. We operationalize coherence by examining consistency between international, EU and national rules on three important aspects of LAC: (i) specific targets for LAC; (ii) transition period for entry into force; (iii) eligible instruments, particularly debt subordination. This allows us to identify and investigate the contradictions between different sets of rules, as explained in detail in the empirical sections.

Many factors may undermine regulatory coherence. Most importantly, a variety of policy actors with different preferences and powers mobilize at various levels and in several policy venues, where different decision-making rules apply, while coordination mechanisms are weak (Bach and Newman 2014; special issue of *Public Administration* 2016, 94(1); Koop and Lodge 2014). Against this backdrop, we argue that regulators can play an important role in pursuing regulatory coherence in finance. To answer the question why regulators seek to promote coherence, we examine their main incentives. To begin with, financial regulators are likely to share similar views based on the same body of technical knowledge (Tsingou 2015); they have extensive experience in international cooperation and they are somewhat insulated from politicians and the financial industry (Eberlein and Newman 2008; Jordana 2017). For example, the Basel Committee of Banking Supervisors (BCBS) was described as an embryonic 'epistemic community' (Kapstein 1992). The BCBS was established in 1974 as the primary international standard-setter for the prudential regulation of banks and for supervisory cooperation. In the EU, bank supervisors gathered in the European Banking Authority (EBA) engage in 'a deliberative process' in which 'national officials come together to convince each other of the value of their approaches' (Heims 2016, p. 890). Furthermore, EBA staff act as 'pragmatic facilitators' on controversial issues to avoid stalemates and delays in adopting common EU rules (Heims 2016, p. 891).

Second, financial regulators have an incentive to ensure coherence because of their mandate to protect financial stability, which would be jeopardized by incoherent rules on matters that require cross-border cooperation, such as dealing with ailing G-SIBs. Cooperation at the international and the EU levels is part of regulators' official responsibilities. For example, the statute of the BCBS includes among the responsibilities of its members the promotion of 'the interests of global financial stability and not solely national interests, while participating in BCBS work and decision-making' (Article 5, Charter of the BCBS). The members of the EBA's Board of Supervisors, the agency's main decision-making body, are required to 'act independently and objectively in the sole interest of the Union as a whole' and they must not 'seek or take instructions' from their government or other public or private bodies (Article 42, EBA Regulation 1093/2010).

However, financial regulators are not purely technocratic actors insulated from the economy and politics of the national context in which they are embedded (Singer 2007). As suggested by the literature, financial regulators have two (sometimes competing) objectives: to safeguard financial stability and to promote the competitiveness of their national financial sector (Kapstein 1989). The first objective has become part of the official mandate of regulatory bodies, especially post-crisis, whereas the second one is often implicit. Considering the mobility of banks and their cross-border activities, regulators often have to cooperate internationally and at the regional level (EU) in order to pursue both objectives (Singer 2007). At the domestic level, regulators are subject to lobbying by banks, and, less frequently, to pressure from elected officials concerned about domestic political and economic objectives. Hence, regulators have to be mindful of the implications of international and regional rules designed to protect financial stability for the competitiveness of domestic banks (Howarth and Quaglia 2016; Spendzharova and Bayram 2016). In several areas of financial regulation, such as bank structural reforms, the lack of coherence may be warranted because different jurisdictions have different national financial systems (Quaglia and Spendzharova 2017). However, in the case of LAC, regulatory fragmentation makes it difficult for regulators to deal effectively and in a timely manner with ailing G-SIBs, which in turn jeopardizes domestic and international financial stability (Avgouleas et al. 2013). After the international financial crisis, regulators' revised mandate explicitly including financial stability responsibilities gives them a stronger incentive to seek more coherent rules on LAC.

To answer the question how regulators seek to promote coherence, we focus on their delegated competences. Specifically in finance, regulators are rule-makers at the international level, where they draft, negotiate and eventually agree upon international standards among themselves. They are rule-drafters at the EU level, whereby they draft regulatory technical standards, but their proposals may be overruled by the European Commission. Regulators also advise the Council of Ministers and the European Parliament on the adoption of EU legislation. At the national level, regulators mostly have an advisory role and can issue administrative guidelines, but the domestic rules are often set by parliaments and governments, which may result in the adoption of diverging national rules across the EU. By contrast, in the US financial regulatory agencies have stronger rule-making powers.

Methodologically, we carry out a longitudinal case study of rule-making on LAC over a four-year period. As explained earlier, we consider LAC to be a most-likely case for regulatory coherence to occur. We conduct process tracing of rule-making on this matter on three governance levels—international, regional (EU), and selected EU member states—and in multiple policy venues to find out whether and how regulators seek to introduce more consistency in the adopted rules. Process tracing allows us to detect instances of fragmentation and contradiction between different sets of LAC rules, and to examine whether they persist. Furthermore, we investigate why and how regulators seek to ensure more consistency. Data were collected through a systematic survey of financial press coverage, policy documents issued by the relevant actors, official position papers, and semi-structured elite interviews with policymakers and stakeholders in Brussels, the UK and Italy.

3 | THE MAZE OF LAC REGULATION AND ITS POLITICAL ECONOMY

The basic rationale of LAC is to ensure that banks hold a sufficient amount of liabilities that could easily be bailed in if banks face financial difficulties. De facto, banks are expected to issue new specifically bail-inable types of debt. This debt is less expensive than traditional 'regulatory capital', which is stipulated by the Basel Accords, but it is more expensive than non bail-inable debt, because it implies a higher risk for creditors, who may, therefore, require a higher yield. Several objectives are at stake when setting the rules of LAC. A first objective is to safeguard financial stability by making sure that banks have enough LAC for bail-in to take place and to do so without causing financial contagion and, ultimately, triggering a financial crisis. A second objective is to minimize the public costs of bank resolution by making the bail-in of banks possible in practice, without resorting to a bail-out by the state. A third objective is to avoid regulatory inconsistency across jurisdictions, which would make the bail-in of cross-border banks unworkable in practice. Moreover, coherent rules are needed to maintain a level playing field across jurisdictions and not to harm the competitiveness of banks because LAC is expensive. Yet, the costs of LAC are different for different banking systems. For example, an Italian regulator (interview, Rome) argued that 'the amount of LAC has to reconcile two sacrosanct needs: on the one hand, to avoid taxpayers' money ending up in the hands of the banks that may have to be saved in the future; on the other hand, to prevent this "draconian care" from killing the banking system'.

Considering the political economy of LAC rules, we can glean the overall preferences of banks and the particular concerns of banks domiciled in the four EU member states analysed in this article. Having an overarching goal to keep regulatory costs low, banks would have preferred a lower (or no specific) target for LAC, a long transition period (or no specific date of entry into force) and a vast array of eligible debt instruments. However, banks in the UK and US were overall well positioned to meet the relatively high targets of LAC with a limited transition period (*Euromoney*, 26 October 2015; interviews, London). By contrast, French, German and Italian banks, which issued a limited amount of eligible debt (i.e., bail-inable bonds), would have problems to meet the high targets of LAC with a limited transition period (*Euromoney*, 3 April 2017; interviews, Brussels). These banks were also keen to have a broad category of eligible LAC instruments. Italian banks were overall in worse financial health than French and German banks, but France has four G-SIBs to which LAC rules apply. Germany, like Italy, has only one G-SIB. Lastly, it is very costly for Italian banks to issue bail-inable bonds, which cannot be sold to retail investors because Italy does not have a large wholesale market for bank debt (*Euromoney*, 18 April 2016; interview, Rome).

The international LAC standard for G-SIBs was issued by the Financial Stability Board (FSB) in late 2015. The FSB was established in the wake of the international financial crisis in 2009 to promote international financial stability by coordinating the actions of different national financial authorities and international standard-setting bodies. The EU adopted the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) regulation in 2014. Both pieces of legislation mentioned the 'minimum requirement for own funds and eligible liabilities' (MREL), which was a distinctive form of LAC that applied to all banks in the EU. However, there were some important differences between the MREL and the LAC. The MREL applied to all banks in the EU, whereas the LAC applied only to G-SIBs. The MREL was set for each bank, whereas the LAC was a common minimum standard for all G-SIBs. The criteria for the MREL were spelled out in regulatory technical standards adopted by the EU in early 2016. In late 2016, the EU began discussing new legislation in order to implement the international LAC standard. In the meantime, however, Germany, Italy, France and the UK had adopted national legislation that differed in several important aspects, including LAC eligibility. The convoluted temporal sequence of adopting LAC rules presented a challenge for regulatory coherence. This multi-level and multi-venue regulatory maze is captured in Figure 1.

4 | THE INTERNATIONAL LAC STANDARD

At the international level, regulators working together in transgovernmental networks were the main rule-makers, to be precise, the standard-setters. Specifically, the FSB brought together central bankers, financial supervisors and treasury ministry officials from the Group of Twenty (G20) countries. In the case of smaller G20 jurisdictions, only the national central bank is a member of the FSB. Moreover, on issues related to bank resolution and LAC, central banks and banking supervisors were in the driving seat (interviews, London, Rome) and, indeed, there were no treasury officials in the relevant FSB working groups. The BCBS, which brings together central bankers and banking supervisors from the G20, was also involved in standard-setting on LAC, mainly by conducting a quantitative impact assessment study. The FSB proposed the 'Total Loss-Absorbing Capacity standard for global systemically important banks' in November 2014 and eventually adopted it in November 2015. LAC is a minimum requirement on the

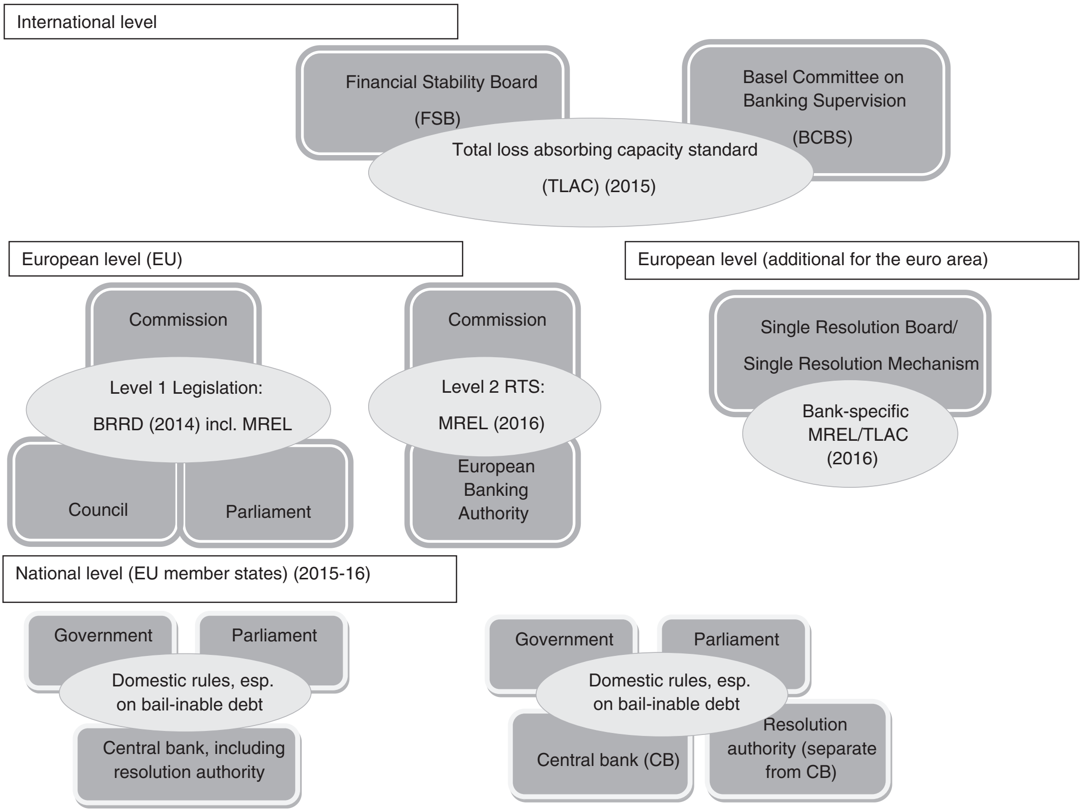

FIGURE 1 Multi-level multi-venue rule-making on loss absorbing capacity (LAC)

liabilities side of G-SIBs' balance sheets, specifying that losses should be absorbed before operating liabilities, such as deposits and derivatives.

The main sponsors of the international standard on LAC were US and UK financial regulators, namely, the Federal Reserve (Tarullo 2012; Gibson 2013) and the Bank of England (Gracie 2012). The deputy governor of the Bank of England, Gracie (2014, p. 783), argued that a minimum LAC standard had to be set internationally to make the liability structures of G-SIBs 'compatible with resolution and time-consistent in a cross-border context'. European regulators also endorsed the international LAC standard. The Vice-President of the ECB, Constâncio (2015, p. 2), stated that the standard would 'reduce the externalities of failure of systemically important institutions' and secure 'a global level playing field'. The president of the Bundesbank, Weidmann (2014, p. 1), considered LAC as 'an essential requirement for the credibility of the bail-in regime'. The Governor of the Banque de France, Noyer (2015; author's translation), pointed out 'the need to coordinate in the best possible way EU and international rules on TLAC'. Hence, official statements by regulators, corroborated by semi-structured elite interviews, suggest that financial regulators shared similar views on LAC, agreed on the rationale of the new rules, and were aware of the need to ensure coherence between the international standard and EU legislation. For example, as shown in the previous section on the domestic political economy of LAC, British and Italian regulators had very different concerns when it came to specifying the LAC rules. Still, they agreed on the importance of having consistent LAC rules at the international and EU levels for the rules to be effective (interviews, London, Rome).

Among the issues that required some negotiations within the FSB, three stand out, namely: (i) the target for LAC, that is, the quantities of bail-inable liabilities that banks should be required to have, (ii) the transition period and (iii) the eligibility, referring to which liabilities should count for LAC. With reference to these issues, there were important differences between the initial proposal put forward by the FSB in 2014 and the standard which was eventually adopted in November 2015. While banks attained an important concession on the risk-weighted assets target, they did not achieve all their goals. For example, banks lobbied for a lower target for LAC (e.g., British Bankers Association (BBA) 2015; French Banking Federation (FBF) 2015a; European Banking Federation (EBF) 2015; Institute for International Finance (IIF) 2015; Italian Banking Association (ABI) 2015) and the FSB's original proposal was indeed revised downwards, moving the target from 20 per cent to 18 per cent of risk-weighted assets. However, banks had asked for an even lower level. Moreover, the total leverage ratio of 6.75 per cent (another way to set the target for LAC) was confirmed despite lobbying by the financial industry (BBA 2015; FBF 2015a, EBF 2015; IIF 2015). Concerning eligibility, the use of countercyclical capital buffers to meet LAC requirements was not allowed despite the industry's lobbying, but the final standard included a broader category of eligible LAC instruments, which were still subject to statutory, contractual or structural subordination. A longer transition period was not secured despite the demands of the financial industry (*Euromoney*, 19 December 2016).

On the one hand, regulators were aware of the distributional effects of the new rules, that is the costs of the LAC standard for the banking systems in their respective jurisdictions. Hence, they negotiated international LAC rules that were not unduly penalizing for different national banking systems (Finance Watch 2016). On the other hand, banks did not achieve everything they wanted, suggesting that regulators, which had extensive rule-making competences with reference to international standard-setting (indeed, regulators, not elected officials, were the rule-makers at this level), were able to partly withstand financial lobbying and to promote regulatory coherence.

5 | LAC AND MREL LEGISLATION IN THE EU

We detect an important lack of coherence between the international and the EU rules on LAC concerning timing and content. As for timing, the concept of MREL was included in the BRRD in 2014, but the criteria to calculate the MREL were spelled out by regulatory technical standards adopted in early 2016, after the LAC standard had been issued by the FSB in 2015. Furthermore, the EU proposed new legislation in late 2016 to implement the international LAC standard. As for content, there was pressure from banks and national governments for EU rules to partly diverge from international standards on three aspects: (i) the target for LAC and the way to calculate it, (ii) the transition period and (iii) the eligible instruments and debt subordination rules. As we show below, regulators working in the EBA and the European Central Bank (ECB) repeatedly intervened in the regulatory process, trying to promote coherence between the agreed international standard and the forthcoming EU rules.

In the EBA, regulators played a key role in crafting the draft EU regulatory technical standards in a way that promoted the consistency of these rules with the international standard. The EBA (2015) wanted its regulatory technical standards to be consistent with the proposed FSB's LAC standards and stressed that 'The [EU] regulatory technical standards should not present additional obstacles to resolution authorities implementing the MREL for G-SIBs consistently with the international framework'. The FSB first proposed LAC targets between 16 per cent and 20 per cent of risk-weighted assets and the EBA's proposal for regulatory technical standards from July 2016 was within that margin. The final figure eventually agreed upon by the FSB was 18 per cent. The FSB proposed the implementation of LAC by January 2019. This was also the date set by the EBA's draft regulatory technical standards (EBA 2015). Regarding the eligibility of LAC instruments, the EBA recognized that this matter was outside the scope of the regulatory technical standards and, therefore, new EU legislation on debt subordination was needed (EBA 2015). Afterwards, the EBA repeatedly called for the Commission to propose this legislation, as explained below. It is noteworthy that regulators in the EBA were able to withstand pressure from the financial industry to a considerable extent. Notably, the majority of banks opposed a specific target for LAC/MREL and a fixed transition period, as suggested by the responses to the public consultation of the EBA on this matter.[2] Yet, the EBA did not accommodate these requests.

[2]These responses are available at https://www.eba.europa.eu/-/eba-consults-on-criteria-for-determining-the-minimum-requirement-for-own-funds-and-eligible-liabilities-mrel-

In December 2015, the European Commission disagreed with some of the regulatory technical standards drafted by the EBA and amended them. Specifically, the Commission decided not to set a specific target for LAC/MREL for G-SIBs and removed the specific deadline for the entry into force of the new rules. In February 2016, the EBA formally objected to the Commission's amendments, pointing out that it was necessary to secure the same levels of LAC and a common transition period for G-SIBs across the EU, in a manner consistent with the international standard (EBA 2016a). However, whereas at the international level central bankers and banking supervisors were the main rule-makers, this was not the case at the EU level. In May 2016, the Commission adopted the regulatory technical standards disregarding some of the initial rules drafted by the EBA (see Delegated Regulation 2976 final).

Reportedly, the Commission's decision was prompted by pressure from the banking industry and some national governments, first and foremost, those of France and Italy (Finance Watch 2016; interviews, Brussels). Several banks and banking associations, such as the French and Italian banking associations (ABI 2015; FBF 2015b), expressed concerns about setting specific targets for LAC/MREL. The German Banking Industry Committee (GBIC 2015) wanted a longer transition period. The Italian G-SIB Unicredit (2015) criticized the EBA for 'exceeding what was required by the BRRD … making MREL compliant with LAC'. National governments also intervened in the policy debate to promote rules favourable to their banks. In a joint paper, the French and Italian finance ministries questioned the rationale of introducing a target for MREL/LAC (Finance Watch 2016).

Most of the EBA's suggestions were designed to align international and EU rules, especially key provisions concerning the amount of LAC, entry into force and the eligibility of debt instruments. The EBA's (2016b) report was prepared in close cooperation with the ECB and the Single Resolution Board (SRB), an EU agency at the centre of the Single Resolution Mechanism (SRM), which is in charge of setting specific MREL/TLAC for each G-SIB operating in the European Banking Union. The Chair of the EBA, Enria (2016) explained that 'Our standards lay out the requirements for G-SIB in such a way as to be compatible with the global requirements set by the FSB on LAC'. Concerning the amount of LAC, the EBA (2016b) suggested that international and EU rules should set the same target. The deadline for entry into force of international and EU rules should also be the same. Concerning the eligibility of LAC, the EBA recommended that G-SIBs should issue subordinated instruments in line with the international LAC standard. Furthermore, the EBA supported statutory subordination of LAC instruments through EU legislation. The EBA and the ECB (see Mersch 2016) also called for new EU legislation on common subordination requirements for debt to be subject to bail-in because 'any implementation of the BRRD in different ways may lead to a re-fragmentation'.

In late November 2016, the Commission put forward two legislative proposals with a view to implementing the international LAC standard in the EU. To begin with, there was a proposal to amend the BRRD and the Capital Requirements Regulation and Directive. The proposal incorporated most of the suggestions put forward by the EBA to ensure coherence between international and EU rules on LAC for G-SIBs. Specifically, it set an MREL target for G-SIBs, whose level was equal to FSB's LAC target and whose timeframe was also in line with the FSB's standard: 16 per cent of risk-weighted assets from January 2019 and 18 per cent from January 2022. However, the negotiations of this legislation have not been concluded yet due to political disagreements among elected officials in the Council of Ministers (Council of the European Union 2018). Moreover, as suggested by the EBA and the ECB, another legislative proposal was put forward concerning 'the ranking of unsecured debt instruments in insolvency hierarchy', explicitly stating that it was a response to the uncoordinated legislation adopted in (some) member states (European Commission 2016, p. 4). Eventually, the new debt subordination rules were agreed upon and adopted through a fast-tracked amendment to the BRRD in late 2017.

In an overall assessment, central bankers and banking supervisors at the EBA and the ECB actively advocated greater coherence between international, EU and national rules. Regulators did so when the EBA drafted regulatory technical standards in 2015, subsequently dissenting from the Commission's decision, and when the EBA and the ECB advised the Commission in the preparation of legislation in 2016. However, one set of proposed LAC rules was stalled for more than 16 months due to ongoing discussions between the European Parliament and the Council of Ministers, where domestic concerns of elected officials played a bigger role.

6 | NATIONAL LAC LEGISLATION IN KEY EU MEMBER STATES

We observe an important lack of coherence in the EU member states concerning the timing and the content of EU and national legislation on LAC. Regarding timing, certain national rules were adopted in 2015, before the EU rules were finalized. As for content, there were important divergences in national rules concerning debt subordination and the hierarchy of creditors. We provide an overview of the domestic rule-making process in four key EU member states—Germany, France, Italy and the UK. Three of these are in the euro area and one, the UK, is outside the euro area and is about to leave the EU. We focus on these four cases not only because of their large banking sectors but also because they were the first ones to adopt controversial legislation on LAC. This led to divergence, especially concerning debt subordination rules, and de facto undermined the international standard on LAC as well as the EU's MREL rules.

Initially, in a quest for a political compromise, EU legislation (the BRRD) deliberately refrained from regulating debt subordination in resolution. This approach left the matter to be decided by elected officials in the member states through national legislation even though both the EBA and the ECB had called for EU-wide rules to prevent a regulatory patchwork across the Union. As shown below, different national approaches were used to specify debt subordination of LAC and MREL eligible liabilities, so achieving a political compromise led to divergences and contradictions among the adopted national rules. Germany, France and Italy pursued statutory subordination of certain types of senior unsecured debt. In the statutory subordination model, additional national legislation designates the hierarchy of creditors in the event of resolution and bail-in. The UK opted for structural subordination achieved by liability issuance from a holding company that sits above the operating companies in the legal entity structure.

Germany was the first country to implement the BRRD into national legislation adopted by the German parliament in November 2014. There was an important amendment concerning LAC in March 2015, creating a new class of super subordinated debt which broadened the total amount of available bail-inable debt (*Euromoney*, 1 June 2015). For large parts of the German banking sector, this implied a head-start in building sufficient amounts of MREL and LAC. Reportedly, the two largest banks in Germany, Deutsche Bank and Commerzbank, were delighted with what they dubbed 'the German LAC solution' (Global Capital 2015).

Italy implemented the BRRD in November 2015 by adopting two legislative decrees drafted by the government and subsequently approved by the parliament. The Italian law extended the protection from the application of the bail-in rule to all individual depositors. By and large, the Italian banking industry supported the LAC provisions in the decree law. Indeed, in its response to the FSB's consultation in early 2015, the Italian Banking Association (2015) had proposed to 'grant corporate deposits a form of preference above senior debt'. In practice, this measure offered greater protection to the deposits of individuals and firms and was largely seen as geared toward appeasing the Italian voters.

In France, the BRRD had initially been implemented through an administrative ordinance adopted by the government in August 2015, which was then confirmed by parliament in December 2016. The legislation established a new class of 'senior non-preferred debt instruments', which consisted of securities subordinated to other senior obligations, but ranked senior to subordinated debt. The ECB (2016) noted that these rules gave 'French G-SIBs an additional option to meet their LAC requirement' and in January 2017 all four G-SIBs in France rushed to issue this new type of bail-inable bonds (*Financial Times*, 20 January 2017).

In the UK, the BRRD was implemented through the BRRD Order of 2016, drafted by the Treasury and endorsed by Parliament. The Bank of England was the lead organization in calibrating and implementing the MREL and LAC rules. The bank decided in favour of structural subordination, involving the issuance of bail-inable debt by a holding company for banks. UK-incorporated banks already had a holding company model, which limited the costs of issuing bail-inable debt at the top, with the partial exception of HSBC, due to its different business structure. In the context of an impending Brexit, the Bank of England (2016, p. 10) emphasized the importance of coherence between UK national legislation and the relevant global rules.

Three negative effects for financial stability and a level playing field in the EU ensued from the different pieces of national banking legislation discussed in this section. First, financial stability was potentially undermined because the different creditor hierarchies specified in the debt subordination rules would make very cumbersome the resolution of cross-border banks, especially G-SIBs. Second, with reference to the level playing field, the divergence in national rules fragmented the market for bank debt, making more difficult the correct pricing of bank debts. Third, national legislation gave an advantage to banks operating in the respective jurisdictions, especially home-based G-SIBs. Elected officials in the national governments and parliaments sought to reduce the costs for national banks to comply with the new LAC rules by adjusting EU legislation and the international standard to the national context, even if that led to a regulatory patchwork and market fragmentation to the detriment of financial stability and a level playing field.

The ensuing fragmentation in different EU member states was a crucial challenge for regulators in the implementation of the overall LAC regime. For example, in its opinion, the ECB (2017) reiterated that 'harmonized rules' on the treatment of bank creditors were needed in order to reduce divergences between national rules concerning the LAC, 'which could distort competition in the internal market'. The ECB also stressed that 'harmonisation in this area is particularly important to safeguard financial stability as well as to foster effective and efficient resolution action, including the implementation of the bail-in tool in a cross-border context'. Eventually, as explained in the previous section, new EU legislation on debt subordination rules was adopted through a fast-tracked amendment to the BRRD in late 2017.[3]

7 | ALTERNATIVE EXPLANATIONS

We consider two alternative explanations developed with reference to multi-level financial regulation and which could be potentially relevant to shed light on the dynamics of regulatory coherence in the case of LAC. A first alternative explanation could be that the sequencing (Posner 2010; Newman and Posner 2016, 2018) in the adoption of international, EU and national rules affected regulatory coherence. To begin with, if a large jurisdiction (notably, the US and more recently, the EU) first adopts domestic rules concerning a specific financial service, it is then well positioned to shape international financial standards on the matter. Such sequencing would promote the coherence between international and domestic rules. This explanation works well with reference to accounting standards, whereby the US developed domestic accounting standards first, which allowed this 'first mover' jurisdiction to strongly influence the setting of international standards (Posner 2010), resulting in a high degree of coherence between international and US accounting rules.

However, in the case of LAC, neither the US nor the EU had pre-existing domestic rules which could be used as templates for international standards. In other words, there were not first movers, by which we mean jurisdictions that adopted full-fledged LAC rules before any international standards. Moreover, the sequencing was rather convoluted: some EU rules predated the international LAC standard, but they required the issuing of further technical guidelines about how to apply the new concepts in practice. Yet another set of rules and guidelines were issued at the national level before either EU or international rules were agreed upon. The dynamics observed in the LAC case are also rather different from those in bank resolution. EU rules on bank resolution (BRRD) were issued after international standards had been agreed upon and the sequencing was not detrimental to regulatory coherence. It was not very problematic for the EU to incorporate the FSB's 'Key Attributes' (2011) into the BRRD (2014) (Quaglia 2017).

A second alternative explanation considers the structural and instrumental power of the financial industry in promoting (or hampering) regulatory coherence (Culpepper and Reinke 2014; Woll 2014). One line of argumentation could be that the financial industry, especially internationally active banks and cross-border financial institutions,

[3]The full name of the legislative instrument is 'Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy'.

have incentives to promote regulatory coherence, as this reduces their costs of complying with different sets of rules. However, other scholars have emphasized the heterogeneity of the preferences of different financial industry actors (Young and Park 2013; Young and Pagliari 2017), especially those of banks which are embedded in distinctive domestic banking systems (Howarth and Quaglia 2016). From this standpoint, banks have an incentive to seek rules specifically tailored to their business model and domestic context, leading to regulatory fragmentation. We observe some evidence of this trend in LAC rule-making, especially at the EU and national levels, but we argue that regulators were an important countervailing force.

On the one hand, the financial industry lobbied regulators and elected officials and mobilized at the domestic, EU and international levels. On the other hand, banks did not achieve all their objectives—as detailed in the previous sections—namely, a lower target or no set target for LAC, a longer or no fixed transition period, a broad set of eligible debt instruments. And to the extent that banks partly got what they wanted, this was mostly due to the intervention of elected officials in the regulatory process, such as the pressure of the French, German and Italian governments on the Commission to amend the EBA's regulatory technical standards and the impasse in the Council of Ministers concerning the new LAC legislation.

8 | CONCLUSION

This article analysed the rule-making on LAC, which unfolded at different governance levels and in multiple policy venues in close temporal proximity. The main findings are that financial regulators were key players in the quest for coherence on LAC because of the incentives related to financial stability, especially to ensure the resolvability of cross-border banks in practice. The (partial) ability of regulators to secure coherence depended on their delegated competences, specifically their roles as rule-makers and rules-drafters. Regarding the theoretical contribution to the literature, the results complement the findings of Posner (2010) and Newman and Posner (2016, 2018) about the 'sequencing' and 'transnational feedbacks' between international and domestic regulatory changes. We also refine findings about the ability of regulators to craft 'organizational compromises' (Egeberg and Trondal 2016), reduce 'rule overlaps' and 'resolve disputes' (Farrell and Newman 2014).

The LAC case also speaks to the literature on the public salience of financial regulation (Culpepper 2011; Helleiner and Pagliari 2011; Pagliari 2013; Moschella and Pinto this issue). This literature would predict that the timing of the LAC debates in the EU—when the levels of public salience had already begun to subside—would enable the financial industry to significantly shape the adopted rules. However, our analysis shows that on multiple occasions the adopted LAC rules were not aligned with the preferences of financial industry actors despite the obscurity of the LAC case and the lower levels of public salience. Finally, our findings speak to the research on the (limited) democratic legitimacy of international networks of regulators. Pre-crisis, these 'technocrats' embraced 'regulatory liberalism' and had considerable room for manoeuvre in setting financial rules because they were able to evade the domestic political arena (Mügge 2011). Post-crisis, we find greater domestic oversight of the rules that financial regulators have agreed upon at the international level. Similarly to other international soft law standards, such as the Basel Accords (Quaglia 2018), in the LAC case, regulators were confronted with pressure from elected officials and domestic banks to implement national rules that were different from those agreed upon internationally.

By focusing on regulators—in this case, central bankers, banking supervisors and resolution authorities and their networks—our findings speak to the first theme of the symposium, namely, the new delegated competences of central banks after 2008. On the one hand, regulators were well positioned to ensure some coherence between the various rule-making processes because they shared similar technical knowledge and were active at all levels in multiple venues. In many cases post-crisis, they were explicitly mandated to safeguard financial stability. On the other hand, the extent of their competences as rule-makers, rule-drafters and advisers varied significantly across governance levels, and so did their ability to promote coherent rules.

Regulators gathered in a trans-governmental network (the FSB) to set banking regulation at the international level. They agreed on a new international LAC standard that sought to secure financial stability and a level playing field across jurisdictions. In the EU, regulators were able to shape the rules through their participation in the EBA and the ECB. Regulators in the EBA drafted the regulatory technical standards, but they were not the ultimate decision-makers. The EBA and the ECB also advised the Commission on the preparation of new EU legislation on LAC. Regulators worried about making the bail-in rules workable in practice and paid attention to the consistency between international LAC standards, EU legislation and national legislation. The technocratic solutions articulated by financial regulators gathered in the EBA and the ECB often clashed with the preferences of the elected officials in the member states. Referring to the second theme of the symposium, bureaucratic politics, our analysis highlights the 'tug of war' between regulators and elected officials in shaping financial sector rules. These diverging preferences and the ensuing consequences for regulatory coherence came to the fore especially at the national level, where legislation was drafted and adopted by elected officials.

ACKNOWLEDGEMENTS

We wish to thank the two anonymous *Public Administration* reviewers, the journal editors, and the symposium guest editors for their perceptive and constructive comments. We also wish to thank the participants in the symposium workshop at the *Scuola Normale Superiore* in Florence, the 'Politics and Culture in Europe' research colloquium at Maastricht University, and the ECPR 'Regulatory Governance' conference in Lausanne.

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How to cite this article: Quaglia L, Spendzharova A. Regulators and the quest for coherence in finance: The case of loss absorbing capacity for banks. *Public Admin*. 2019;97:499–512. https://doi.org/10.1111/padm.12549